ONTARIO TRADE STUDIES #1

THE IMPLICATIONS OF NATIONAL TREATMENT IN A FREE TRADE AGREEMENT

MINISTRY OF INDUSTRY, TRADE AND TECHNOLOGY
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CANADA
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THE IMPLICATIONS OF A NATIONAL TREATMENT IN A FREE TRADE AGREEMENT

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THE MINISTRY OF INDUSTRY, TRADE AND TECHNOLOGY
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EXECUTIVE SUMMARY

On June 16, 1986 in a nationally televised address, on the future of Canadian-American trade negotiations, Prime Minister Mulroney stated:

> We will seek what, in the jargon of trade negotiators is called "national treatment" whereby goods from Manitoba will be treated exactly the same as goods from Minnesota.

The purpose of this paper is to:

(a) explain the concept of national treatment and its current role in the conduct of international trade relations; and

(b) analyze the federal-provincial implications of a broad national treatment standard in a Canada-U.S.A. trade arrangement.

The Concept of National Treatment

The legal framework for the conduct of international commercial relations is founded on the principle of non-discrimination. For Canada, as for more than ninety other countries around the world, this commitment to international non-discrimination is primarily made through adherence to the General Agreement on Tariffs and Trade (GATT) -- an agreement covering international trade in goods.

The concept of national treatment, together with the complementary concept of most-favoured-nation treatment (MFN), are the two basic precepts which give practical effect to the GATT principle of non-discrimination.

The MFN obligation (as expressed in Article I of the GATT) addresses the issue of external discrimination. It obliges countries to not discriminate among differently owned or sourced imports at the border i.e. goods produced in one country will not be granted more favourable treatment or access in the importing country than goods produced in another.

National treatment, on the other hand, affects the domestic policies and internal politics of a contracting party by prohibiting or limiting internal discrimination. It means that once goods have entered into the territory of a contracting state, the host country will treat such imported goods no less favourably than goods of domestic origin in terms of taxes, laws, regulations and other requirements.

Taken together, these two concepts create the philosophical underpinnings for a system designed to achieve, maintain and preserve trade liberalization. That system envisions non-discriminatory tariffs as the sole mechanism to regulate competition between imports and domestically produced goods, a negotiating process to reduce such tariffs on a non-discriminatory basis, and a prohibition against internal laws and regulations that would nullify the benefits of such negotiated concessions.

While the GATT envisions such a system in principle, important derogations from the principle of non-discrimination and the national treatment standard exist within the GATT rules. In particular, both government procurement practices and production subsidies are explicitly allowed on a discriminatory basis. As well, the concept of a free trade area envisioned by Article XXIV of the GATT -- the objective of the Canadian-American negotiations -- creates a preferential system between the two countries.

Further erosion of the GATT principle of non-discrimination has been caused by the increasing recourse to GATT-sanctioned "contingency protection" measures such as anti-dumping and countervailing duties -- instruments which allow Contracting Parties to discriminate between foreign goods as well as between foreign and domestic products, in order to offset condemned practices. There is also increased use of grey measures, such as OMA's and VRA's which give effect to safeguard actions without respecting MFN requirements, and often ignoring the need to demonstrate injury.

The resort to such "contingency protection" measures and the extensive use of other sophisticated non-tariff barriers can be seen as the result of past GATT success in lowering tariffs and harmonizing tariff schedules. GATT negotiations, from their inception, have centered on the principal regulator of trade at the border -- the tariff. The issue of discrimination therefore revolved around the application of MFN treatment. Starting with the Kennedy Round in the 1960s and continuing with the Tokyo Round of the 1970s, GATT member states began to address the problems related to non-tariff barriers, with a corresponding increase in the importance of national treatment. Given the highly sensitive nature of these policies, the initial objective, however, was not their elimination, but the introduction of greater discipline and transparency. The result has been the gradual introduction of sophisticated, discriminatory commercial policy instruments that are tolerated, if not sanctioned.

These two factors (the procurement and subsidies derogations and the increased reliance on contingency protection) have limited the effectiveness of a national treatment standard in traded goods. Such a standard has been further eroded by the increased importance of trade in services and the changing role of investment and capital flows in an increasingly integrated economy.

Whereas high tariff walls formerly induced the creation of subsidiaries inside these walls, the reduction of tariffs since World War II and the power of modern technologies have caused a profound shift in the factors affecting production location decisions, and therefore international trade. Many multinational enterprises have restructured their operations to allow local companies to manufacture a specific product or products for the world market and to market the full range of products in their home market. Others are producing finished products locally, using imported components and technology. Still others have organized different aspects of production on an international basis based on global comparative advantage.

Such global economic integration has caused a number of leading industrialized nations, led by the United States, to intensify their efforts to expand the principles of non-discrimination -- particularly national treatment -- beyond trade in goods to the regulation of investment flows.

This effort by the United States to define international rules for investment is not new. The U.S. has long sought to introduce the principle of non-discrimination in the investment area both bilaterally and multilaterally. In most bilateral treaties (the so-called Treaties of Friendship, Common and Navigation [FCN]) entered into by the U.S., there is mention of the right of establishment as well as "open and equitable treatment" for U.S. investment. The Reagan administration has also developed a model bilateral investment agreement for negotiation with LDCs, which explicitly incorporates right of establishment and national treatment standards. Agreements based on the model treaty have been reached with Egypt and Panama.

Multilaterally, the U.S. has been the prime mover in the OECD for adoption of two non-contractual codes of conduct: the 1961 Code on the Liberalization of Capital Movements on Right of Establishment; and the 1976 Declaration on International Investment and Multinational Enterprises on National Treatment. These codes were addressed by the OECD Council Decision on National Treatment, where member countries of the OECD agreed that each OECD country should treat foreign-controlled domestic companies the same as domestically controlled domestic companies. In all these instruments, the U.S. has sought to define the basic principle of non-discrimination in investment as:

(i) national treatment with regard to the right of establishment, and

(ii) national treatment once established within the host country.

Despite these efforts, the United States and other nations wish to go beyond the OECD arrangements, since they are weakened by a number of factors, including:

(a) the agreements are formed by consensus, and do not operate in a more or less enforceable contractual trade agreement fashion, as does the GATT;

(b) OECD membership does not include developing countries or state-trading countries;

(c) it is possible to maintain "reservations" and "derogations" indefinitely without penalties;

(d) there are no enforcement mechanisms, no real dispute settlement mechanisms nor sanctions for non-compliance.

While GATT covers trade in goods, and the OECD has attempted to formulate general rules regarding investment, no corresponding rules exist for trade in services. Here too, the United States is attempting to establish an international framework with rules of general application founded on the concept of national treatment.

Despite the absence of general international rules, however, trade in services is not conducted in a vacuum. On the contrary, such activity is performed through a myriad of highly differentiated national and international regulating regimes. For example, international rules governing trade in services have been successfully negotiated in the aviation sector. The so-called "Chicago Convention" establishing the International Civil Aviation Organization (ICAO), as supplemented by bilateral air traffic agreements, provides for national treatment in regard to the use of aviation facilities and charges for the use of airports and other facilities. It does not, however, provide national treatment in regard to route sharing. Other sector arrangements, such as the International Telecommunications Union, effectively create national treatment obligations by the imposition of standards of behaviour.

While some services sectors have managed to develop carefully articulated international rules, particularly in sectors requiring technical norms, others, such as insurance, operate at the other extreme. In many sectors, such agreement will be extremely difficult, given the complications that flow from the notion of services. Since services may be provided across borders or through a facility in the host country, barriers to trade in such activities raise such issues as investment (the right of establishment), the movement of service personnel (immigration) and domestic regulation (licensing powers). Such issues become even more difficult in federal states with constitutional division of powers.

Despite such difficulties, the United States is vigorously pursuing its commercial interests in multilateral and bilateral negotiations. The Reagan administration has designated rules regarding investment and traded services as top priorities in the anticipated GATT negotiations. At the same time, they have used existing American trade laws to address alleged perceived "unfair" trade practices in certain countries, including: Korean Insurance practices, Japanese procurement and tobacco monopoly practices, Brazilian computer trade policies and Mexican pharmaceutical policies.

National Treatment and a Canada-U.S. Trade Agreement

The application of a broad national treatment standard in a comprehensive Canada-U.S.A. free trade arrangement would be breaking new ground in international trade law. It is the first occasion when the concept of national treatment described in Article III of the GATT has been combined with the concept of a free trade area as envisaged in Article XXIV.

While the precedent-setting nature of these negotiations allows the parties considerable flexibility to create pragmatic exceptions to the general rule, national treatment for all goods in a free trade area, as described by the Prime Minister, implies the elimination of all tariffs and procurement preferences, the prohibition of particular subsidy practices, and possibly the end of contingency protection remedies in bilateral trade.

Such an extension of national treatment to all goods, in its purest form would significantly impact provincial autonomy. Provincial governments and their agencies would have to eliminate existing procurement preferences of local producers. Production subsidies and tax preferences to specific beneficiary groups would necessarily be constrained. Existing provincial practices in the sale and distribution of alcoholic beverages would come under review. Laws and regulations governing the marketing and processing of agricultural and fisheries products would be challenged. Product certification standards would need to be harmonized. In short, many of the laws and regulations governing Canadian economic life would require fundamental change.

Should the two countries seek to go beyond trade in goods and formulated rules of conduct in investment and trade in services, the issue of national treatment raises even more difficult and controversial questions. Such an arrangement would go well beyond the scope of a free trade area as defined in Article XXIV of the GATT, which requires only the elimination of duties and other regulations of commerce on "substantially all trade in products".

At its broadest theoretical level, national treatment on bilateral trade in goods, services and investment would mean that all commerce between the two countries would be conducted on the same basis as commerce within either country. To name but two of many issues, provincial autonomy over the licencing of trades and professions and control over American participation in such sectors as transportation and securities markets would be severely constrained.

Clearly, the concept of a broad national treatment standard in a comprehensive Canadian-American bilateral agreement raises a number of profound and difficult questions. While the concept may present opportunities for certain Canadian sectors through increased access to American procurement markets and protection from American trade laws, it also presents considerable danger to others. Indeed, the vastly different impact of national treatment on different sectors of the economy calls into question the utility of a comprehensive standard for both countries. Given the precedent-setting nature of these negotiations, extreme caution, careful sector-by-sector study and extensive public debate is clearly warranted.

TABLE OF CONTENTS

		Page
1.	INTRODUCTION	1
2.	WHAT IS NATIONAL TREATMENT	3
2.1	In GATT	3
2.2	National Treatment in Bilateral Treaties	4
2.3	National Treatment in the EEC, and EFTA, and U.S.-Israel FTA	5
3.	INTERNATIONAL ORGANIZATIONS AND AGREEMENTS	6
4.	CURRENT AMERICAN ACTIONS AND TACTICS	8
4.1	Brazil Informatics	8
4.2	Korean Insurance and Intellectual Property	8
4.3	Japan Tobacco Monopoly	9
4.4	Mexican Pharmaceuticals	10
4.5	Kansei Airport Procurement	10
5.	NATIONAL TREATMENT AND A CANADA-U.S. TRADE AGREEMENT	13
5.1	Trade In Goods	13
5.2	National Treatment in Contingency Protection	13
5.3	Investment	14
5.4	Services	19
6.	NATIONAL TREATMENT AND PROVINCIAL AUTONOMY	21
6.1	The Provinces and GATT	21
6.2	The Provinces and a Canada-U.S. Trade Agreement	23
7.	CONCLUSIONS	28

ANNEXES

ANNEX A Havana Charter

ANNEX B Extract From U.S.-Japan FCN Treaty

ANNEX C California's International Service Industries

1. INTRODUCTION

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National treatment, on the other hand, affects the domestic policies and internal politics of a contracting party by prohibiting or limiting international discrimination.

According to international trade law expert professor John Jackson of the University of Michigan,

> National treatment in its simplest sense means that imported "goods" will be accorded the same treatment as goods of local origin with respect to matters under government control such as taxation and regulation.

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The United States, on the other hand, has long pursued the expansion of the national treatment beyond trade in goods into the fields of investment and trade in services. Such an objective in the Canada-U.S. trade negotiation raises complex and difficult issues in relation to:

- trade in numerous service sectors;
- trade in products presently excluded from the GATT Procurement Code;
- trade in sectors under provincial jurisdiction;
- investment-related issues;
- intellectual property issues;
- and a range of other issues which may impair both national and provincial sovereignty.

It is hoped that this paper, in exploring these issues will help to stimulate the debate and discussion which will make possible better informed choices and decisions.

2. WHAT IS NATIONAL TREATMENT

National Treatment seems to mean different things to different people in different countries. As a concept, 'National Treatment' has a long history. It has been a feature of bilateral trade agreements for hundreds of years.

A simple definition of the concept as it relates to goods is that once a product has crossed a frontier and duties of Customs have been paid, it should be treated the same in respect of taxation and regulation as a similar product originating in the country of import. However, in various agreements, the concept has been defined in much more precise terms.

2.1 In GATT

In order to fully understand the meaning of national treatment in the GATT, it is useful to begin with the American "Proposals" of 1945 for multilateral rules of conduct in international commerce. In Chapter III of the Proposals: "General Commercial Policy", the opening phrases are:

> Members should undertake:
> (1) To accord to products imported from other members treatment no less favourable than that accorded to domestic products with regard to matters affecting the internal taxation and regulation of the trade in goods.

This provision became the nine paragraphs of Article 18 in the Havana Charter (see Annex A) which in due course became Article III of the less ambitious GATT.

In the GATT, "national treatment", as set out in Article III, has a narrow and precise meaning. It makes clear that, except for procurement by governments of goods for their own use, (not services, on which the GATT is, in the main, silent), imported goods, once the tariff has been paid, are to be treated precisely as domestic goods. Of the most important measures which are specified in this context are commodity taxes and value added taxes.

Article III is a key provision: in a sense, taken with Article I (MFN), and Article II (which provides for the "binding" of rates of duty), this is the architecture of the GATT system: protection is to be afforded by tariffs, in the normal case, applied on an MFN basis, and no protection is to be afforded by the differential levying of internal taxes or other nominally internal measures. It is a mistake to speak of the GATT as a "free trade" device; as the preamble to the General Agreement makes clear, it is directed to the "substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment".

Taking the first three articles together, it is clear that the GATT system is designed to ensure that subject to the agreed exceptions, tariffs are the sole permitted means of protection, the sole means by which the state intervenes to regulate the competition between imports and domestic products -- and to provide that such tariffs be levied on a non-discriminatory basis and be negotiable.

2.2 National Treatment In Bilateral Treaties

The concept of national treatment was developed, in regard to goods in bilateral treaties, to ensure that there would be no additional barrier to imports, other than duties of Customs imposed at the frontier. After payment of these duties, imports were not to be disadvantaged opposite domestic products by any domestic tax, other measure or regulation. This was a feature of many pre-GATT bilateral trade agreements and treaties. For example, the 1933 Trade Agreement between Canada and France, Article 8, provides that:

> The internal taxes which are levied in the territory of one of the High Contracting Parties for the benefit of any authority on the production, circulation, conditioning, offering for sale, sale or consumption of natural or manufactured products, shall not, under any pretext, affect the goods of the other Party after importation to a higher degree or in more onerous conditions than similar national products.

Many pre-World War II bilateral treaties dealt with issues beyond tariffs and trade. United Kingdom "treaties of commerce and navigation" and American "treaties of Friendship, Commerce and Navigation" (FCN), contained NT provision in regard to the rights of nationals and business firms of the one country to receive national treatment in regard to such matters as taxation, the conduct of a business, the ownership of property, and in regard to their standing before the courts, in the other country. Clauses dealing with charges levied on ships were frequently cast in NT terms.

The origin of these NT provisions appears to have been concern to ensure that the nationals of a given country would be treated fairly when doing business abroad. Indeed, the European metropolitan powers carried this concern to an extreme position when they developed the systems of consular courts -- the system under which their nationals could be charged for certain offences or sued only in special courts under consular jurisdiction in which the domestic law of their own country was applied.

To cite the consular court system is merely to show how far countries went to protect their businessmen abroad, particularly when they had no confidence in "national treatment" in a particular country. It also serves to demonstrate how far the concept can be taken in a bilateral free trade negotiation if both partners are willing.

The practice of inserting NT clauses in bilateral trade or FCN treaties has continued in the post-war period, in parallel with the evolution of the GATT. A major example is the U.S./Japan FCN Treaty of 1953, before Japan adhered to the GATT (in 1955). This agreement contains nine provisions relating to National Treatment. Those provisions most relevant to a possible negotiation between Canada and the U.S.A. involving trade in services are paragraphs (1) and (2) of Article VII, and (2) of Article VIII. These provisions are set out in Annex B.

2.3 National Treatment in the EEC, and EFTA, and U.S.-Israel FTA

One of the important events of the post-war era was the establishment of the European Economic Community. The Rome Treaty, establishing the EEC, provided for not only a customs union (i.e., removal of internal tariffs and other trade restrictions and establishment of a Common External Tariff (CET) and a common commercial policy towards third countries) but also the following other important measures of integration:

- free movement of capital and persons and freedom to supply services;
- a common agricultural policy;
- a common transport policy;
- a system for ensuring competition;
- procedures for coordinating domestic economic policies and dealing with balance of payments problems;
- removal of differences in national laws where necessary for operating the common market;
- a social fund to facilitate adjustment;
- a European investment bank to assist development;
- the association of dependent overseas territories;
- provisions for admitting other European states to the Community;
- provision for concluding "Unions of states" or association arrangements with other third countries or international organizations.

Clearly, Canada and the United States do not want to go this far.

More relevant precedents may be the European Free Trade Association (EFTA) and the recent U.S.-Israel Free Trade Area. EFTA effectively incorporates the GATT national treatment obligations and extends them to those industrial products which are duty-free. National treatment is not extended to contingency protection, emergency action on imports, investment or services.

The U.S.-Israel FTA, effectively extends the GATT national treatment obligation to certain government procurement business and to a list of products which will gradually become duty-free over the next decade. The agreement does not cover contingency protection such as dumping, countervail and safeguard remedies. It does, however commit each country to endeavour to ensure that trade in services is governed by the principle of national treatment.

3. INTERNATIONAL ORGANIZATIONS AND AGREEMENTS

While the GATT is the principal international agreement governing trade in goods, other international organizations have attempted to create rules of conduct governing investment and trade in certain services sectors. (At present, there is no broad contractual framework with rules of general application for trade in services.)

Multilaterally, the U.S. has been the prime mover in the OECD for adoption of two non-contractual codes of conduct: the 1961 Code on the Liberalization of Capital Movements on Right of Establishment; and the 1976 Declaration on International Investment and Multinational Enterprises on National Treatment. These codes were addressed by the OECD Council Decision on National Treatment, where member countries of the OECD agreed that each OECD country should treat foreign-controlled domestic companies the same as domestically controlled domestic companies. In all these instruments, the U.S. has sought to define the basic principle of non-discrimination in investment as:

(i) national treatment with regard to the right of establishment, and
(ii) national treatment once established within the host country.

While OECD member states have endorsed this general principle, many countries have notified many derogations, or particular circumstances in which they will not apply this NT provision. As well, this Decision, like the OECD Codes (on Capital Movements and on Invisibles) does not, in practice, operate in a contractual trade agreement fashion. As the U.S. GATT Study (on services) pointed out in regard to the OECD Invisibles Code, such OECD arrangements are weakened by a number of factors: (1) The OECD does not include developing countries or state-trading countries (2) It is relatively easy to maintain "reservations" and "derogations" indefinitely and without incurring any penalty (3) There are no effective enforcement mechanisms, no real dispute settlement mechanisms, no sanctions for non-compliance.

The weakness of the OECD NT Decision became apparent when the U.S. decided to challenge the "performance requirements" imposed by Canada on foreign-controlled companies wishing to establish in Canada (or take over a Canadian-controlled corporation). While limitations on the rights of foreigners to establish are not uncommon in OECD countries, and, indeed, there are a number of legislated prohibitions of this category in the U.S., the U.S. decided to challenge the particular technique of imposing conditions or "performance" requirements. On the face of it, the Canadian practice under the then Foreign Investment Review Act (FIRA) was contrary to the OECD NT Decision. But what was the status of the Decision? Was Canada bound by it, in the sense of having accepted a treaty obligation? Is having a representative in the room when a Decision is adopted by a consensus the same, in effect, as the signature of a treaty by a representative of the State carrying a "full power"? And what was the status of the observations, reservations, derogations to this Decision? Could they be approximated to reservations under treaty practice? The answers to these questions were so unclear, it seemed, that the U.S. opted to challenge the Canadian practice under GATT Article III.

While no multilateral organization has yet devised a broad framework for trade in services, such activity is not performed in a vacuum. On the contrary, there exist a myriad of highly differentiated national and international regulating regimes, some of which apply a national treatment standard. The most obvious example is ICAO -- the 1944 so-called "Chicago Convention" establishing the International Civil Aviation Organization, as supplemented by the arrangements undertaken by the International Air Transport Association, and bilateral air traffic agreements. ICAO provides for NT in regard to the use of aviation facilities, charges for the use of airports and other facilities. It does not, however, provide NT in regard to route sharing. In virtually all countries, domestic routes are reserved for domestic carriers, and foreign carriers, although they may be "established" for purposes of carrying on international traffic, have no access to purely domestic traffic. International routes are normally allocated by bilateral treaties. This sectoral structure makes clear that, as a practical matter, national treatment in a service industry is meaningful only if it is related precisely to a particular category or measure.

There are other sector arrangements, such as the International Telecommunication Union (ITU), the provisions of which may, in effect, create NT obligations by the imposition of standards or norms of behaviour. These standards or norms may, if their technical character so requires, be taken into domestic legislation (for example, in regard to such matters as interface standards for data-processing and computer access, as developed under ITU auspices). Indeed, when one looks, even briefly, at the existing sector arrangements, it is difficult to avoid the conclusion that meaningful rights and obligations to accord NT will be feasible only at the technical level. The practical difficulty to be faced is, of course, that there is at present a considerable difference between the carefully articulated structure of agreements in the aviation sector, at one extreme, and the lack of comparable arrangements in the insurance sector, at the other extreme.

Such differences are hardly surprising, given the vast differences in the economic structure of different services. The list of California service industries in Annex C confirms these differences. Resolving these differences is made even more difficult by the complications that flow from the notion of services in a "wired world". Since services may be provided across borders or through a facility in the host country, barriers to trade in such activities raise such issues as investment (the right of establishment), the movement of service personnel (immigration) and domestic regulation (licensing powers). Such issues become even more difficult in federal states with constitutional division of powers.

Despite these difficulties, international organizations have begun the process of negotiating general rules. For example, a general policy statement on services issued by the International Chambre of Commerce calls for an unlimited "right of establishment and comprehensive national treatment of such establishments".

4. CURRENT AMERICAN ACTIONS AND TACTICS

The U.S. desire to ensure that its nationals and their companies received fair and equitable treatment in foreign markets has led to a number of recent disputes with their important trading partners.

4.1 Brazil Informatics

Brazil has taken initiatives to develop indigenous computer and software industries. They have limited imports of non-essential products (but permitted imports of non-available computer equipment). This has caused concern to U.S. industry and to the Administration.

In 1985, the United States continued to object to Brazil's informatics policy during U.S.-Brazilian Investment Task Force consultations and through other official channels of communication. On September 7, along with cases involving other countries, President Reagan ordered the USTR to investigate and determine under authority of section 301 of the Trade Act of 1974 whether Brazil's informatics law constitutes unfair trade practices under GATT rules.

"Informatics" is broadly defined in Brazil and covers designated categories of computers, telecommunications equipment, and any other product containing a digital component, including telecommunications and data processing services. Passed in October 1984, the informatics law reserves the domestic market for nationally owned suppliers in the designed areas through 1992.

Access of U.S. products and investment to the Brazilian informatics market had been sharply restricted for years before the 1984 legislation formalized restrictions already in effect. U.S. firms claimed that these practices prevented them from participating fully in the rapidly expanding Brazilian market. The implementing regulations for the 1984 law are presently being developed by CONIN, Brazil's policymaking authority on informatics. CONIN is comprised of public and private sector industry representatives.

4.2 Korean Insurance and Intellectual Property

In late 1985, in accordance with section 301 of the U.S. Trade and Tariff Act of 1974, the USTR initiated unfair trade investigations into Korea's insurance industry policies and practices concerning intellectual property rights. Bilateral consultations began shortly after initiations of these cases.

The insurance investigation was initiated in September 1985. The USTR charged that Korea's insurance market policy prohibits or restricts foreign firms from providing services under the same terms and conditions as those applicable to domestic companies. Foreign companies, for example, may not underwrite life insurance or certain types of fire insurance.

Following bilateral negotiations held in December, an agreement was reached to open gradually the fire and life insurance sectors to foreign companies beginning in 1986.

The second 301 case regarding Korea was initiated in October. The United States charged that U.S. intellectual property is denied effective protection under Korean law. Of particular concern were practices involving trademarks, patents, and copyrights.

Trademark licenses in Korea are granted on a case-by-case basis and are only issued to a company in which a foreign firm is the majority partner or has an approved joint venture or technical assistance agreement. This restriction limits the licensing of most foreign trademarks in Korea. Since Korea's trademark law requires a trademark's use if registration is to be maintained, effective protection is denied since high tariffs and import restrictions keep many products out of the Korean marketplace.

The Korean patent law does not include foodstuffs or chemical compounds and compositions. Protection for chemicals and pharmaceuticals is limited to process patents only. Korea has a copyright law but it is not party to any international copyright agreement, nor does it have a bilateral copyright agreement with the United States. Thus, U.S. authors are not afforded copyright protection in Korea.

During the bilateral negotiations, accords were more readily reached in those areas requiring changes in the law or entering into international copyright agreements. Reaching agreements on remedies for Korea's lack of protection in the area of software and chemical-substance patents was most difficult. Changes in these laws could threaten some of Korea's major industries, such as pharmaceuticals. Korea agreed to stronger protection for trademarks and the easing of restrictions on licensing of foreign trademarks. An accord was not reached on copyright protection, although Korea agreed to revise its copyright law and join either the Universal Copyright Convention or the Berne Convention by 1988. No agreement was reached on product patents.

4.3 Japan Tobacco Monopoly

Japan's restrictions on sales of foreign cigarettes were singled out by the President on September 7, 1985 for investigation under section 301 of the Trade Act of 1974. A formal proceeding was initiated by USTR on September 16, 1985. Despite recent changes in Tokyo's pricing policies for imported cigarettes and its eased restrictions on marketing, advertising, and distribution, the United States maintains that U.S. cigarette makers are still handicapped in competing with Japan Tobacco Inc. (JTI), the country's only authorized cigarette manufacturer. Their biggest disadvantage, say U.S. suppliers, is the fact that Japan's tobacco excise tax, equivalent to 56.5 per cent of the retail price, is calculated on the landed price of imported cigarettes, including the 20 percent tariff. This results in a significant price differential between foreign and Japanese cigarettes and keeps the U.S. share of Japan's $10 billion annual market for cigarettes at about 2 percent, U.S. industry sources claim.

The Japanese Government has countered that its tariff on cigarettes is lower than the United States' and points to the number of changes that it has made in its cigarette market at the request of the United States. Specifically, the Japanese Government directed the administration's attention to the fact that restrictions on access to retail outlets have been reduced considerably, foreign cigarette companies can now set their own retail prices subject to minimal government criteria, tobacco product manufacturers are free to establish retailer margins, foreign tobacco companies can set up their own distribution system or use JTI's existing network, and advertising rules are applied equally to foreign and domestic firms. U.S. makers, meanwhile, believe that various aspects of Japan's tariff, tax, distribution, and marketing systems continue to inhibit their presence in the Japanese market for cigarettes and other manufactured tobacco products.

4.4 Mexican Pharmaceuticals

On April 3, 1985, the Mexican Government responded to urgings from the United States and announced modifications to its controversial pharmaceutical regulations. The pharmaceutical decree, announced in February 1984 with implementing regulations issued the following October, was designed to reduce the dominance of foreign-based firms in Mexico's pharmaceutical production. Another objective of the decree was to increase the supply of low-cost medicines. The measure gave Mexican-owned firms preferential treatment in the form of subsidies and by awarding them government contracts. Controls applying to the industry -- such as mandatory prices, generic labeling stipulations, mandatory disclosure of formulae (which could then be copied by competitors) -- mainly affected foreign companies.

Supported by the U.S. Government, U.S. pharmaceutical companies and other foreign companies operating in Mexico claimed that the decree eroded their patent and trade market protection; that the controlled prices failed to reflect their R&D costs; and that the regulations generally interfered with their ability to respond to market forces. Canada has heard similar claims.

The revisions to the Mexican pharmaceutical decree announced in April 1985 responded to some of these objections. The changes provided that the controlled prices must adequately reflect the R&D costs of products. The new measures also reauthorized companies to display their trademarks on certain packages beside the generic names. Some exemptions from generic labeling were also allowed for 10 more years, and the rules on mandatory disclosure of formulae were eased. However, further U.S. demands are anticipated in respect of private controls and generic labeling.

4.5 Kansei Airport Procurement

Kansei is the area of Japan where Osaka is located. A major airport construction project is underway there. The U.S. Government has for some time been pressuring the Japanese authorities for U.S. involvement in the construction and servicing of the facility.

A brief summary of this current issue is contained in the August 18, 1986 Statement by Senator Frank Murkowski:

United States Senator Frank Murkowski today applauded Commerce Secretary Malcolm Baldrige and United States Trade Representative Clayton Yeutter for telling the Government of Japan that only the full and immediate employment of an open procurement policy can forestall formal trade action by the U.S. government.

"I am very pleased that the U.S. Trade Representative's response to our section 305 request has confirmed that the Osaka airport project's procurement policy is discriminatory, and that a section 301 trade action against the Japanese remains a live option," said Murkowski.

Murkowski is Chairman of the Senate Republican Conference Task Force on International Trade Policy which, in June 24th, sent an inquiry under section 305 of the Trade Act of 1974 to Ambassador Yeutter. The inquiry asked that an investigation be launched into allegations that the Japanese government has prohibited U.S. contractors from bidding on the $8 billion Oskaka airport project.

Yeutter's response to Murkowski confirmed that, although U.S. firms have shown tremendous interest in the project, the Japanese government has consistently refused to allow U.S. firms to bid on the project. By contrast, Japanese construction companies did $1.8 billion worth of work in the U.S. last year.

Yeutter informed Murkowski that Undersecretary of Commerce Bruce Smart will be in Japan this week seeking a written understanding that a non-discriminatory system will be applied immediately to the Osaka airport project and to other major public works contracting by the Japanese government.

"For the Japanese to claim that U.S. firms are not reliable in this kind of work is ridiculous," said Murkowski. "They've precluded Boeing, McDonnell Douglas, IBM, Dupont, Goodyear, Caterpillar, and Lockheed from this project. I can't imagine who they've included who they think is more reliable."

The Task Force also requested that Yeutter determine whether a case could be made for trade retaliation against Japan for its closed-door policy on procurement for major projects, including Osaka airport. The letter was signed by Senators Murkowski, Danforth, Symms, McClure, Chafee, Mattingly, Kassebaum, Roth, Nickles, and Trible, all members of the Task Force.

"All three elements necessary for a case for retaliation have been ratified," Murkowski said. "The policies are governmental, not private. The policy is clearly discriminatory. And the policy adversely affects U.S. commerce.

"Some U.S. firms have been trying to bid on this project for over five years," Murkowski added, "but consistently they have been denied opportunities and discouraged from applying.

"With this sorry record, American patience is at an end. I support the Administration's carrot-and-stick approach of seeking a change to the policy through Undersecretary Smart's mission while holding real trade retaliation open if no change is forthcoming."

5. NATIONAL TREATMENT AND A CANADA-U.S. TRADE AGREEMENT

The application of a broad national treatment standard in a comprehensive Canada-U.S.A. free trade arrangement would be breaking new ground in International trade law. It is perhaps the first occasion when the concept of national treatment described in Article III of the GATT has been combined with the concept of a free trade area as envisaged in Article XXIV. Given that the precedent-setting nature of these negotiations allows the parties to create pragmatic exceptions to this general rule, it is impossible to give a precise analysis of the impact of a broad national treatment standard. The following analysis therefore outlines some of the issues at play.

5.1 Trade In Goods

As noted earlier, the principal derogation from national treatment in the GATT remains government procurement. The attempt by GATT member states to liberalize procurement markets through a Procurement Code has so far met with limited success. Procurement by junior governments (states, provinces, etc.) is not covered. Nor is procurement below a certain threshold (SDR 150,000, is about $156,000 U.S. at the end of 1985). Most military procurement is excluded and there are other exceptions which vary on a country-specific basis.

Both Canada and the United States desire a broadening of this code. As such, the creation of a more liberalized "Buy-North America" code on a conditional most-favoured-nation basis could well be an area of common agreement.

5.2 National Treatment in Contingency Protection

Canada has stated that it is seeking an exemption from U.S. contingency protection legislation, that is, the laws which discipline injurious imports benefitting from dumping and/or subsidization.

The United States has reacted coolly to those suggestions. The Washington reaction is that if Canada did not subsidize or did not export products which benefit from subsidies, we would have no need to fear the disciplines of the U.S. countervailing duty legislation. Experts consider that the only way Canada might gain an exemption from U.S. countervailing duty law is to submit all subsidy programs, and many incentives granted through the tax system, federal, state, and provincial, to the scrutiny of a joint Canada-U.S. committee in order to determine the acceptability of such programs or tax policies. The implications for sovereignty are overwhelming and the scope for a broad mechanism of this nature would appear to be unlikely.

However, given the nature of some of the programs which the U.S. investigated in fish and pork, and which Canada is investigating in corn it might be useful for both sides to sit down to try to resolve precisely which types of government programs and incentives should be subject to countervailing duty action, and which are normal functions of government. Such discussions would be consistent with the Canadian desire to extend the concept of national treatment. At the same time, it might be possible to agree on common procedures and legal tests in contingency protection systems which would limit the scope of countervailing laws. For example, higher thresholds of injury and clearer causality links between an alleged subsidy and injury to the complainant would greatly improve the objectivity and fairness of these laws. As well, consideration could be given to reinstating the former American practice of "offsetting" those subsidies which merely make regionally located plants economically viable.

Anti-dumping laws raise another set of issues. Anti-dumping laws are designed to address international price discrimination in much the same way as anti-trust and anti-combines laws address it in a domestic context. It is difficult to see how either Canada or the United States could condone price discrimination by foreigners, particularly if it causes or threatens material injury to local producers. This may not be negotiable, unless the countries subjected these problems to a common anti-trust discipline. Canadians contemplating this would be well advised to recall the treble damages provisions and rights of action available to individuals under U.S. anti-trust laws.

5.3 Investment

Whereas high tariff walls formerly induced the creation of subsidiaries inside these walls, the reduction of tariffs since World War II and the power of modern technologies have caused a profound shift in the factors affecting production location decisions, and therefore international trade. Many multinational enterprises have restructured their operations to allow local companies to manufacture a specific product or products for the world market and to market the full range of products in their home market. Others are producing finished products locally, using imported components and technology. Still others have organized different aspects of production on an international basis based on global comparative advantage.

Such global economic integration has caused a number of leading industrialized nations, led by the United States, to intensify their efforts to expand the principles of non-discrimination -- particularly national treatment -- beyond trade in goods to the regulation of investment flows. Thereby eliminating trade-related performance requirements.

In recent years, the Reagan Administration has developed a model bilateral investment treaty incorporating a national treatment standard for negotiations with LDC's, and agreements have been reached with Panama and Egypt.

The Canada-U.S. negotiations is seen by the United States as an opportunity to create a similar precedent for relations between industrialized countries. In essence, they seek an agreement which binds Canada to OECD standards, without the right to create indefinite derogations.

American concerns over investment issues are, of course, not new to Canada. They resulted in an aggressive American attack on Canadian practices under the Foreign Investment Review Act (FIRA) and the National Energy Program. The U.S. authorities challenged certain aspects of Canada's FIRA procedures under GATT, first under Article XXII, and then Article XXIII. Not all of the U.S. concerns were met by the GATT Panel decision, but it did result in some changes in FIRA procedures and thresholds. Those concerns which were not addressed by the GATT decision can be expected to be raised during the bilateral negotiations.

Negotiations concerning issues such as the "right of establishment", if they in fact take place, are bound to be controversial, if only because U.S. policy perceptions are so different from those of Canada and other countries. Many developing countries (e.g. Mexico) stipulate that control and majority ownership of domestic corporations must be in the hands of nationals, and the majority of the board of directors must be nationals. Many countries (e.g. U.K., France) impose "conditions" when foreign corporations propose to establish subsidiaries (or take over domestic corporations) and their governments reserve the right to refuse permission to the foreign corporation to "establish" in the domestic jurisdiction. (For regulated industries, e.g. banks, insurance companies, telecommunications companies, there are special rules, in virtually all jurisdictions, with respect to foreign corporations, frequently involving reciprocity considerations.) The U.S., on the other hand, has proceeded broadly in legislating either specific prohibitions on foreign firms or persons in particular sectors, or limitations on foreign participation.

American spokesmen, being conscious of the fact that in those sectors where these limitations and prohibitions do not apply, foreign corporations may freely establish themselves in the U.S., are inclined to think of the U.S. as being more "liberal" than others. Such a perception, however, may not be true.

Despite the favourable image that government and business interests in the United States try to project internationally of their general willingness to accept foreign investments, a number of legislative and non-legislative barriers to Canadian investment in the United States do, in fact, exist. The nature and extent of these barriers were analyzed in a study by Canada's Foreign Investment Review Agency. The FIRA study concluded:

> The foreign investor contemplating the establishment or acquisition of a business in the U.S. must be prepared to cope with a plethora of laws, regulations, agencies, hearings, programs and ordinances at both the state and federal levels. He must be prepared for ambiguous rules and unexpected delays. He must be prepared to find that regulatory agencies such as the Interstate Commerce Commission, the National Aeronautics Board, or the Securities and Exchange Commission, may go beyond their traditional mandate and in fact examine and bar his investment precisely because it is not U.S. controlled. He must be prepared for unexpected legal expenses and the possibility that his business intentions will be publicly questioned and villified.

Legislative barriers in the United States may be direct, aimed at existing or prospective foreign investments or indirect in that the controls apply equally to domestic and foreign investment. Barriers of both kinds exist at the federal and state governmental levels. Those at the federal level are more comprehensive.

At the federal level, direct barriers to foreign investment exist primarily in national-interest sectors where the restriction of foreign investment may be effected in a number of ways: outright prohibition, prohibition unless there is a reciprocal exchange of rights, or limitations on stock ownership and on management participation. The main sectors in which barriers to investment exist are: maritime industries, aviation aeronautics, communications, energy, natural resources, defense, banking and emergency provisions. Foreign control is prohibited for coastal and freshwater shipping; domestic carriers; radio, television, telegraph and telephone licences; radio and television operations; and is also prohibited in most cases for defence suppliers from all sectors of the U.S. economy. Foreign control is prohibited unless there is a reciprocal exchange of rights in: fishing; transfer of federally-owned land, and mineral rights for oil and gas. Foreign-controlled enterprises engaged in shipbuilding are barred from receiving government benefits. Restrictions on management and/or stock ownership exist for dredging and salvage operations, air carriers (international), hydro-electric facilities and exploration for deepsea resources. Certain legislation imposes direct controls by limiting stock ownership and/or management by individuals who are not U.S. citizens. Such legislation covers Overseas Private Investment Corporation Insurance and Guarantees, Customs House brokerages, and Business, Industrial Development Loan Guarantees under Farmers Home Administration, Department of Agriculture.

There are a number of indirect barriers to foreign investment at the federal government level in the anti-trust legislation and securities area. While laws or regulations governing these areas apply equally to foreign and domestic investors, the laws and their administration present special problems for the foreign investor because of their complexity and because the legal system in the United States encourages both public and private litigation to enforce these acts.

The anti-trust legislation is contained in the Clayton Act, the Sherman Act, and the Federal Trade Commission Act. Under the Clayton Act a foreign direct investment is subject to scrutiny by Department of Justice officials if it appears or is alleged the investment may lessen competition or create a monopoly. Foreign-controlled firms investing in the United States are subject to the Sherman Act which outlaws conduct which could weaken or eliminate competition. The Federal Trade Commission has the power to forbid acquisition or ownership by an investor, including a foreign investor, that restrains trade or substantially lessens competition within the United States. Uncertainty about the effect of anti-trust legislation and the heavy cost of litigating disputes and investigations may cause investors, particularly foreign investors who are unfamiliar with the U.S. legal system, to abandon or limit their proposed investments.

In the securities areas the principal legislation is the Securities and Exchange Act. An amendment has been proposed to this Act to provide uniform margin requirements for U.S. and foreign investors. The main aim of the amendments is to prevent foreign investors from borrowing higher proportion of the funds used for acquisitions in the United States than U.S. investors are permitted to. Under the proposed margin requirements amendment to the Securities and Exchange Act a violation would occur if a foreign investor obtains beneficial credit for the purchase of U.S. securities which would be contrary to the existing margin requirements which apply to U.S. purchasers and lenders. The Securities and Exchange Act is applied with more rigour than similar legislation in other countries and can be a particular burden to foreign investors. Violations of securities legislation can be used to attack both domestic and foreign investors.

The Interstate Commerce Commission (ICC) regulates common carriers such as railroads, motor and water carriers, and pipelines. In the course of its regulatory activities, the ICC sometimes gets involved in matters related to foreign ownership. A recent exercise of this power occurred when in February 1982, the Interstate Commerce Commission imposed an administrative moratorium on Canada-U.S. transborder trucking that made it impossible for Canadian carriers to obtain operating authorities to which they were entitled under American rules. This position has since been modified but Canadian carriers are still being treated less favourably than American carriers.

Many U.S. states have laws that discriminate against foreign investors. These legislative constraints include limits on and prohibitions of foreign ownership, and requirements for reciprocal treatment. Restrictions exist in a number of states on the ownership of real estate and its use by aliens, and by foreign-controlled enterprises. In several states, state-owned lands may only be acquired by U.S. citizens. Two states impose restrictions on the use of land by aliens.

The insurance industry is regulated by state law. Foreign insurers must satisfy more stringent admission requirements than U.S. insurers. Direct deposit taking operations of foreign banks are subject to state laws which impose a number of restrictions that are not imposed on U.S. banks. Restrictions also exist for foreign controlled enterprises in state regulation of power utilities, railroads, natural gas distribution and commercial fishing. State security laws apply to all investors but can be more burdensome for foreign investors. States have the power to create corporations and in the exercise of this power some states impose limitations on the number of foreign directors or foreign incorporators of certain enterprises, and the terms under which foreigners may hold stock in a corporation.

An information monitoring system has been established to monitor foreign investments flowing into the United States. The Foreign Investment Study Act of 1974 requires the Secretaries of Commerce and the Treasury to study the impact of foreign investments on the United States. The Committee on Foreign Investment in the United States (CFIUS) has primary responsibility for monitoring foreign direct and portfolio investments and for coordinating U.S. policy on foreign investment. The Committee has no legal powers of enforcement. It attempts to achieve its objectives by persuasion using diplomatic channels.

The United States gains international competitive advantage by barring or controlling foreign investment in the national security field and by actively supporting American ownership and control of a wide range of manufacturing and service industries in this area.

The competitive advantage enjoyed by U.S. firms producing goods or services for U.S. defence needs because of the massive U.S. government funding of research and development, and procurement preferences makes it difficult for foreign firms to compete for these markets.

Another area of concern is foreign ownership in the U.S. cable television industry. This has recently become a political issue of growing dimensions. The ramifications of the political debate on this matter are complicating the entry of foreign firms into the cable television industry in the United States.

Finally, there are non-legislative barriers against foreign investment. These barriers are the result of the size and complexity of the United States, the complexity and ambiguity of the laws and regulations, and the very real prospect of challenges to foreigners through litigation from both public and private interests as well as the costs of such litigation.

All these U.S. barriers to investment suggest that both countries would find great difficulty in meeting the ideal standard of national treatment in investment.

5.4 Services

As noted earlier, trade in services raises a number of controversial and complex issues, such as right of establishment, immigration and licensing powers. These issues become more complex in negotiations involving federal states. (The impact of a broad national treatment standard on provincial autonomy will be discussed in section 6, infra.) Clearly, a meaningful general framework of rules will be difficult to achieve.

If it were decided to try to agree to an NT clause covering services delivered by facilities, that is, NT modelled on the OECD Decision, the various national reservations mentioned earlier could be converted into schedules, and made subject to negotiation. Set in the framework of an agreement cast in a treaty format, with a functionally effective conciliation and dispute settlement system, such an NT provision might be meaningful. However, as has already been noted, the differences between different service sectors suggest that the most appropriate approach may well be to put the detail required for a meaningful NT clause into sector specific agreements which are mutually beneficial.

For example, in some service sectors (as in informatics or insurance) it may be relevant and beneficial to both countries to try to formulate what could be called a "right of presence" or, perhaps better, to formulate a parcel of rights which, taken together, would provide assured access for a data processing firm and a user in one country in regard to the market or services available in the other. For a computer services company or a transnational firm (insurance or financial services company) such a right would involve a "right to deliver" a service and a "right to connect" with a customer, broker, branch or subsidiary. For certain firms in one country -- those that buy data processing, it would be a "right to receive" a service from a data processing firm in the other. These balanced rights to send and receive would, of course, be subject to exceptions which would have to be either negotiated and stated in explicit terms in the agreement or made subject to a consultation and amending process.

These rights could also be subject, obviously, to adherence to standards regarding access by computer installations to carriers through interconnection facilities and to standards regarding interface characteristics. (The importance of such emerging standards is examined in a study by G.P. Dallaire, of the Department of Communications; "Implications for Canada of Open Systems Interconnection Standards".)

To be fully effective, these various "rights" would have to be safeguarded by requirements regarding "most-favoured-nation" treatment and "national" treatment. This particular parcel of rights, when taken in the context of "national treatment", is clearly the substantive core of a potential Canada/U.S. bilateral agreement for traded computer services -- the subject of preliminary bilateral discussions in the past.

While some service sectors may well be candidates for early bilateral agreement, others raise more difficult and controversial issues, quite apart from jurisdictional obstacles. Canadian concerns about issues such as immigration and regulation of professions, however, should be somewhat lessened in the knowledge that the United States shares similar concerns.

For example, there has been a clause in most recent FCN treaties to which the U.S. is a party, which has served to limit very sharply the rights conveyed to the professions by such treaties. Moreover, there is for the U.S. the problem that the right to practice certain professions is controlled by the States. In agreeing to the U.S./Japan FCN Treaty, the U.S. Senate added a reservation, as follows:

> Article VII, paragraph 2, shall not extend to professions which, because they involve the performance of functions in a public capacity or in the interest of public health and safety, are state-licensed and reserved by statute or constitution exclusively to citizens of the country, and no most-favoured-nation clause in the said treaty shall apply to such professions.

The Japanese authorities balanced this with the following reservation:

> Japan reserves the right to impose prohibitions or restrictions on nationals of the United States of America with respect to practicing the professions referred to in Article VIII, paragraph 2, to the same extent as States, Territories or possessions of the United States of America, including the District of Colombia, to which such nationals belong impose prohibitions or restrictions on nationals of Japan with respect to practicing such professions.

This is an example of national treatment with a reciprocity proviso, a pattern which, one may prophesy, will be followed in any potential negotiation about services.

6. NATIONAL TREATMENT AND PROVINCIAL AUTONOMY

6.1 The Provinces and GATT

There is much misunderstanding about the rights and obligations of provinces under GATT or the GATT implications of the actions of constituent governments (such as the Canadian provinces).

The provinces have neither GATT rights nor obligations. None are Contracting Parties to GATT.

The basic rule of GATT which applies to the actions of political subdivisions of Contracting Parties, including provinces, is Article XXIV:12 which reads:

> Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territory.
>
> There is an extensive discussion of this paragraph in Jackson's World Trade and the Law of GATT at 110-117.

Professor Jackson notes that:

> Simple and straightforward as it looks, this language contains ambiguity that has an impact on the domestic law application of GATT. The opposing interpretations can be expressed as follows:
>
> a) The language doesn't change the binding application of GATT to political subdivisions, but it recognizes that in a federal state certain matters are legally within the power of subdivisions and beyond the control of the central government. In such a case, the central government is not in breach of its international obligations when a subdivision violates GATT as long as the central government does everything within its power to ensure local observance of GATT.
>
> b) On the contrary, this language indicates that GATT was not intended to apply as a matter of law against local subdivisions at all and, even when a central government has legal power to require legal observance of GATT it is not obligated under GATT to do so, but merely take reasonable measures.

Jackson notes further that the U.S. State Department has adopted position B and a State Department official adopted a similar position before a Senate Committee.

Jackson tends to disagree with alternative B. Because he is a professor of law who operates in the U.S.A., Jackson tends to place great stock in the legislative (or negotiating) history (GATT is an agreement or contract, not a law). Jackson's references on these points are to U.S. law and litigation. Even then the decisions in the U.S. court are split. There is little in GATT precedent to address this issue.

The issue has been addressed in the GATT Panel requested by South Africa against Canada in respect of Ontario's decision to apply sales tax on gold coins in a manner which favours Canadian product.

The dispute between South Africa and Canada began in May 1983 when the provincial government of Ontario exempted the Canadian Maple Leaf gold coin from the 7 percent Ontario retail sales tax, but did not exempt imported gold coins from the tax. At the request of South Africa, the Council established a panel under Article XXIII:2 in November 1984. The report of the panel was considered by the Council in September and again in November 1985. The report concluded that the Ontario retail sales tax was not consistent with the national treatment provisions of Art. III:2 that require equal treatment of domestic and imported products and suggested that the CP's recommend to Canada that it ensure that the actions of Ontario conform to those obligations.

At the November 1985 GATT Council meeting, Canada announced that it agreed with certain findings of the panel and therefore planned to reinstate the retail sales tax on the Canadian Maple Leaf. Thus, the differential treatment between the Canadian coin and other gold coins would be removed and indeed was. However, the report has not yet been adopted due to objections by Canada and some other delegations to certain other rulings of the panel. For example, Canada agreed with the panel finding that the measure violated national treatment provisions of the GATT but not with the finding that the measure violated MFN principles since only the Canadian Maple Leaf, and no other gold coin, whether produced in Canada or any country abroad, were exempted from the tax. On the issue of provincial exclusion the panel did not disagree with the position put forward in this paper but they broke new ground in their interpretation of the requirements imposed on the federal state in order to ensure compliance. This issue remains unresolved.

Canada is not the only federal state having subsidiary governments which introduce actions affecting international trade. There are still in the U.S.A. many state restrictions including Buy-America preferences which Washington seems helpless to deal with. Further, the Twenty-First Amendment to the Constitution of the United States gives the States considerable autonomy to regulate matters related to the marketing of alcoholic beverages. However a recent U.S. court decision suggests that the federal interstate commerce power may take precedence over the Twenty-First Amendment. This is U.S. experience which is of little, if any relevance to Canada. But it will shape U.S. attitudes if and when they challenge provincial actions.

Another view, from Canadian trade official Frank Stone, who notes in his study of GATT for the Institute for Research on Public Policy:

> Canada's international obligations under GATT are not necessarily binding on provincial governments, unless under particular federal-provincial agreements.

Mr. Stone also explains:

> On a number of occasions, Canada's federal government has carried out negotiations in GATT on matters falling within provincial jurisdiction, in agreement with the provinces concerned: on several occasions, the federal government has also intervened with provincial authorities to persuade them to adjust particular programs and measures and to bring them into line with GATT rules.

Stone's interpretation and explanations are, from a Canadian perspective, accurate. They are supportable in GATT.

Another element of this issue is the argument as to whether or not provincial laws and regulations which pre-date the GATT are exempt from GATT rules under the Protocol of Provisional Application -- the so-called "grandfather" clause.

Jackson cites an interesting intervention by the representative of India on this subject.

> At the outset it is necessary to point out that in India the powers to legislate over matters affecting trade and commerce rest not only in the Indian Parliament but also in the Legislature of the States (formerly Provinces of British India and Indian States). Within the time given, no attempt whatsoever could be made to examine the legislation of the various States and no idea therefore can be formed at this stage of the possible scope of Government of India's obligations under paragraph 12 of Article XXIV.

Jackson's view is that Article XXIV:12 applies to those situations where the federal authority can over-ride local legislation. He seems to adopt the view that provincial or local actions pre-dating GATT do not qualify for grandfathering. However, it seems incongruous that federal actions would qualify but that the actions of political subdivisions would not. However, the question does not arise, in our view, because the provinces are not Contracting Parties to GATT. They have neither GATT obligations nor GATT rights. To the Provinces, the Protocol of Provisional Application is irrelevant.

6.2 The Provinces And A Canada-U.S. Trade Agreement

While the scope of an extended national treatment standard cannot be predicted at this time, any meaningful extension of national treatment will inevitably impinge on provincial authority, and will require provincial consent.

The following issues will clearly be discussed in the negotiations:

(a) Alcoholic Beverages

The United States has expressed considerable concern about provincial practices in alcoholic beverages trade. It is the United States' view that provincial liquor boards in Canada impede U.S. sales of beer, wine and liquor. It is claimed that these provincial boards either refuse to carry U.S. products or charge discriminatory mark-ups to discourage their purchase by Canadian consumers.

Ontario is under attack for preferential mark-ups for Ontario wines and the brewers warehousing system for marketing beer.

The goal of the United States is National Treatment, in terms of listing practices and mark-ups. In respect of wine this would require the amendment of the Wine Content Act of Ontario, which requires a minimum of 85 percent usage of Ontario grapes, in order to benefit from the Ontario wine mark-up.

In the beer area, there is a requirement that Canadian breweries marketing beer in Ontario also have a brewery in the province. There are no interprovincial shipments of beer for most provinces. This is done to protect employment in addition to the other public health and morals reasons which led to the establishment of liquor control boards.

National Treatment in a free trade area if extended to these products, which are controlled by provincial constitutional authority, could lead to significant dislocation.

The United States, however, is not without state controls of its own. There are some 18 control states, including Virginia. The Canadian Wine Institute has compiled an extensive catalogue of U.S. state practices which parallel those of Canadian provinces.

On the beer side, while Canadian brewers enjoy substantial exports to the U.S.A., their exports still account for less than 1 percent of U.S. beer consumption. They claim their ability to access and further develop the U.S. market is impaired by domination of the distribution network by the major U.S. brewers.

Any movement from the status quo in this area and in other areas now regulated under provincial constitutional authority, could result in significant adjustments for provincial workers, farmers and alcoholic beverages producers.

(b) Other Sectors of Provincial Jurisdiction

There does not appear to be an adequate understanding of the scope for changes in provincial legislation and regulation which could result from a free trade arrangement with a broad national treatment provision. The principal impact is in procurement, agricultural marketing products and services. For example:

Provincial hydro procurement practices do not meet national treatment standards.

Quebec under its SDI loans programs has requirements to purchase provincial origin products and to export (to other provinces or outside the country) significant portions of production.

Ontario has broad Canadian preference policies over a wide number of product areas. It also has requirements prohibiting the use of non-Canadian firms in the procurement of certain services. Other provinces (e.g. Quebec and B.C.) have stricter local content or local presence rules which discriminate against suppliers from other provinces as well as foreign sources.

These practices discriminate not only against foreigners. They also put suppliers from other parts of Canada at a distinct disadvantage.

The services element of the negotiations will also open up new areas for incursions into provincial responsibilities.

For example, under the:

- Loan and Trust Corporations Act
  - -- Trust and loan companies which are not chartered in Canada may not register in Ontario.
  - -- All registrants must agree to comply with Ontario's restrictions on foreign ownership as a pre-condition of registration (s. 165).

- Insurance Act
  - -- Incorporated insurance agencies and adjusters must be Canadian-owned as a pre-condition to being licensed in Ontario (s. 357[3]).

- Securities Act
  - -- Registration of securities dealers in Ontario is conditional on the applicant establishing Canadian residence and foreign ownership of less than 25 percent in total and less than 10 percent by any one shareholder (s. 31). This sector is currently undergoing extensive regulatory changes.

- Mortgage Brokers Act
  - -- Registered mortgage brokers in Ontario must be Canadian citizens or legal immigrants and must be resident in Canada.
  - -- Foreign ownership of incorporated mortgage brokers is restricted to less than 25 percent in total and less than 10 percent by any one individual.

- Health Disciplines Act
  - -- Regulated health professionals must meet qualifying standards of education (such as Canadian university degrees or equivalent) and other requirements as follows:
    - -- Dental Hygienists: educational requirements only (reg. 446).
    - -- Dentists: educational requirements, fluency in French or English and Canadian citizenship or immigrant visa or employment visa (Reg. 447).
    - -- Doctors: educational requirements, fluency in French or English and Canadian citizenship or immigrant visa or employment visa (Reg. 448).
    - -- Nurses: educational requirements and fluency in English or French (Reg. 449).
    - -- Optometrists: educational requirements, fluency in French or English and Canadian citizenship or immigrant visa or employment visa (Reg. 450).
    - -- Pharmacists: educational requirements, fluency in French or English and Canadian citizenship or immigrant visa or employment visa (Reg. 451).

- Architects Act
  - -- Members of the Council of the Ontario Association of Architects must be Canadian citizens resident in Ontario (s. 3[4]).
  - -- Individual architects must be citizens of Canada or have the status of a permanent resident of Canada (s.13).
  - -- Incorporated architects must be owned by Ontario-licensed architects (s. 21).

- Law Society
  - -- Members of the Ontario Law Society must be Canadian citizens or British subjects and meet the prescribed educational standards (such as a Canadian law degree).
  - -- Foreign law firms are prevented from establishing in Canada by the provincial law societies' legislation which requires that practising lawyers be qualified to the provincial bar. One of the requirements to qualify for practice is Canadian citizenship. By contrast the U.S. permits foreign lawyers to establish as legal consultants to provide advice on Canadian law. As well there are no residency or citizenship requirements for admission to state bars in the U.S.

- Accounting
  - -- In the practice of chartered accounting problems between the Canadian national association of chartered accountants and their U.S. counterpart have arisen concerning accreditation, certification to practice and transborder mobility. Currently there is a joint committee of Canadian and American chartered accountants reviewing this situation. It should be noted that the Canadian national association cannot dictate accreditation policy to the provincial institutes.

- Paperback and Periodical Distribution Act
  - -- Distributors of Canadian paperbacks and periodicals are not regulated in Ontario but distributors of foreign-produced material must be registered under the Act and are licensed to carry on business only in a very restricted territory.

- Development Corporations Act
  - -- Loan guarantees and interest subsidy programs for book publishers and film production companies are restricted to Canadian-owned, Ontario-based firms.

- Small Business Development Corporations Act
  - -- Tax breaks and grants are provided to investors in small businesses paying 75 percent of their wages in Ontario.

- Arts Council Act
  - -- Awards and grants under this Act are generally only available to Ontario artists or to Canadian-owned companies based in Ontario.

- Travel Industry Act
  -- Registered travel agents in Ontario must be bona fide residents of Canada.

- Ministry of Agriculture and Food Act
  -- A rebate of property tax paid on farm property may be given to applicants who are Canadian citizens or lawfully admitted to Canada for permanent residence or, if a corporation, more than 50 percent Canadian owned (O. Reg. 716/83).

- Provincial Auctioneers Act
  -- Persons applying for a licence to sell pure-bred live stock by public auction must pay a fee of $50 if they are Ontario residents or $100 if they are non-residents.

- Crown Timber Act
  -- Every licence to cut Crown timber in Ontario is subject to the condition that the cut timber is to be manufactured in Canada.

This non-exhaustive list suggests that the extension of National Treatment into these and other areas must be examined extremely carefully.

7. CONCLUSIONS

National Treatment is not a simple concept. Its extension to areas when it does not yet apply has significant implications for Canada and the provinces. This suggests that National Treatment should not be addressed on a broad basis but rather on a sector specific basis taking into account the particular interests in each sector.

The concept of national treatment raises many unanswered questions. A few of the more important ones are:

Should the provinces open any or all of the areas now under their jurisdiction to National Treatment?

Will the U.S. states follow?

What are the benefits to Ontario?

What are the benefits to other provinces?

What are the costs?

How far is it feasible to move towards National Treatment in these areas?

Do all of these areas lend themselves to rules about National Treatment?

In many sectors, what value is National Treatment if there is no corresponding Right of Establishment, or Right of Presence?

Clearly, the concept of a broad National Treatment standard in a comprehensive Canadian-American bilateral agreement raises a number of profound and difficult questions.

While the concept may present opportunities for certain Canadian sectors through increased access to American procurement markets and protection from American trade laws, it also presents considerable danger to others. Indeed, the vastly different impact of National Treatment on different sectors of the economy calls into question the utility of a comprehensive standard for both countries.

Given the precedent-setting nature of these negotiations, extreme caution, careful sector-by-sector study and extensive public debate is clearly warranted.

HAVANA CHARTER

ARTICLE 18

NATIONAL TREATMENT ON INTERNAL TAXATION AND REGULATION

1. The Members recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

2. The products of any Member country imported into any other Member country shall not be subject, directly or indirectly, to internal taxes or other applied, directly or indirectly, to like domestic products. Moreover, no Member shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

3. With respect to any existing internal tax which is inconsistent with the provisions of paragraph 2 but which is specifically authorized under a trade agreement, in force on April 10, 1947, in which the import duty on the taxed product is bound against increase, the Member imposing the tax shall be free to postpone the application of the provisions of paragraph 2 to such tax until such time as it can obtain release from the obligations of such trade agreement in order to permit the increase of such duty to the extent necessary to compensate for the elimination of the protective element of the tax.

4. The products of any Member country imported into any other Member country shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations, and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

5. No Member shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amount or proportions which requires, directly or indirectly, that any specified amount of proportion of any product which is the subject of the regulation must be supplied from domestic sources. Moreover, no Member shall otherwise apply internal quantitative regulations in a manner contrary to the principles set forth in paragraph 1.

6. The provisions of paragraph 5 shall not apply to any internal quantitative regulation in force in any Member country on July 1, 1939, April 10, 1947 or on the date of this Charter, at the option of that Member; Provided that any such regulation which is contrary to the provisions of paragraph 5 shall not be modified to the detriment of imports and shall be subject to negotiation and shall accordingly be treated as a customs duty for the purpose of Article 17.

7. No internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions shall be applied in such a manner as to allocate any such amount or proportion among external sources of supply.

8. (a) The provisions of this Article shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale.

(b) The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.

9. The Members recognize that internal maximum price control measures, even though conforming to the other provisions of this Article, can have effects prejudicial to the interest of Member countries supplying imported products. Accordingly, Members applying such measures shall take account of the interests of exporting Member countries with a view to avoiding to the fullest predictable extent such prejudicial effects.

EXTRACT FROM U.S.-JAPAN FCN TREATY

ARTICLE VII

1. Nationals and companies of either Party shall be accorded national treatment with respect to engaging in all types of commercial, industrial, financial and other business activities within the territories of the other Party, whether directly or by agent or through the medium of any form of lawful juridical entity. Accordingly, such nationals and companies shall be permitted within such territories: (a) to establish and maintain branches, agencies, offices, factories and other establishments appropriate to the conduct of their business; (b) to organize companies under the general company laws of such other Party, and to acquire majority interests in companies of such other Party; and (c) to control and manage enterprises which they have established or acquired. Moreover, enterprises which they control, whether in the form of individual proprietorships, companies or otherwise, shall, in all that relates to the conduct of the activities thereof, be accorded treatment no less favourable than that accorded like enterprises controlled by nationals and companies of such other Party.

2. Each Party reserves the right to limit the extent to which aliens may within its territories establish, acquire interests in, or carry on public utilities enterprises or enterprises engaged in shipbuilding, air or water transport, banking involving depository or fiduciary functions, or the exploitation of land or other natural resources. However, new limitations imposed by either party upon the extent to which aliens are accorded national treatment, with respect to carrying on such activities within its territories, shall not be applied as against enterprises which are engaged in such activities therein at the time such new limitations are adopted and which are owned or controlled by nationals and companies of the other Party. Moreover, neither party shall deny to transportation, communications and banking companies of the other Party the right to maintain branches and agencies to perform functions necessary for essentially international operations in which they are permitted to engage.

3. The provisions of paragraph 1 of the present Article shall not prevent either Party from prescribing special formalities in connection with the establishment of alien-controlled enterprises within its territories; but such formalities may not impair the substance of the rights set forth in said paragraph.

4. Nationals and companies of either party, as well as enterprises controlled by such nationals and companies, shall in any event be accorded most-favoured-nation treatment with reference to the matters treated in the present Article.

ARTICLE VIII

1. Nationals and companies of either Party shall be permitted to engage, within the territories of the other Party, accountants and other technical experts, executive personnel, attorneys, agents and other specialists of their choice. Moreover, such nationals and companies shall be permitted to engage accountants and other technical experts regardless of the extent to which they may have qualified for the practice of a profession within the territories of such other party, for the particular purpose of making examinations, audits and technical investigations exclusively for, and rendering reports to, such nationals and companies in connection with the planning and operation of their enterprises, and enterprises in which they have a financial interest, within such territories.

2. Nationals of either Party shall not be barred from practising the professions within the territories of the other party merely by reason of their alienage; but they shall be permitted to engage in professional activities therein upon compliance with the requirements regarding qualifications, residence and competence that are applicable to nationals of such other party."

CALIFORNIA'S INTERNATIONAL SERVICE INDUSTRIES

- Transportation
- Telecommunications
- Banking and financial services
- Insurance and information
- Management consulting
- Research and testing
- Public relations
- Marketing
- Advertising
- Computer and data processing
- Equipment rental and leasing
- Hotels and lodging places
- Commercial photography, graphics
- Employment agencies
- Interior design
- Repair, cleaning and maintenance
- Motion picture production, distribution
- Recreation and sports activities
- Orchestras and entertainers
- Health services
- Education and training
- Engineering, architecture, and surveying
- Construction management
- Accounting, auditing and bookkeeping
- Legal and tax
- Travel and tourism
- Aviation
- Franchising
- Investment management
- Export management services
- Foreign freight forwarding and shipping services
- Political and commercial risk analysis
- Customhouse brokerage
- Translation and interpretation services
- Sales representation and distribution
- Courier and delivery services

Source: California Economic Development Corporation, 1986